

regional economic development with a collection of direct grants, technical support, and various forms of credit assistance. These programs, while often piecemeal and subject to strong political pressures, represent the government's most purposeful attempt to direct economic development below the national level.

Various programs administered by the Small Business Administration, the Farmers Home Administration, and other agencies were implemented to encourage economic development in particular geographical areas or among targeted populations. In most cases these programs were designed to balance economic growth between regions, between rural and urban populations, or between economically underprivileged populations and the general public.

In many ways the debate that preceded enactment of these programs mirrored the industrial policy debate today. Significant population and industry migration, and locally distressed economic conditions, provided the justification for targeted economic development assistance, although industrial dislocations and foreign competition were substantially less widespread than today. Frequently, programs were developed to balance economic opportunity between the prosperous and the underprivileged.

While significant capital expenditures were being made for infrastructure (most importantly, the interstate highway system), special programs were also targeted for underdeveloped regions (the Appalachian Regional Commission), for economically distressed areas (the Area Development Administration, now the Economic Development Administration) and for groups that lack full access to markets (the Small Business Administration).

In most cases, the identified need addressed by the original program grew during implementation and subsequent legislative review. Targeted recipients became more broadly defined, and the definition of distressed areas was loosened without clear economic rationale. Thus, the federal government became a full partner in many regional industrial development programs without the benefit of either national economic development goals nor a defined, coordinated federal role. Federal regional development assistance has been ad hoc and highly politicized.

COMPETITION POLICY

Since this nation's founding, the federal government has been given the task of providing the basic legal framework within which the economy functions. The Congress has a constitutional responsibility to regulate commerce, coin money, fix standard weights and measures, and promote the

progress of science and the useful arts. These basic activities are necessary for the full development of the market system. Some of these activities are quite clear and specific, such as fixing weights and measures. Others, such as regulating commerce, are more vague and general. All of them can be considered as industrial policy in that they affect economic welfare and competitiveness through government policy toward industry.

Two areas in which the Congress has taken action to regulate commerce are discussed below. One of these is regulating competition so as to deter the growth of monopolies and to keep highly competitive industries from destroying themselves. The other involves regulation to achieve social welfare goals.

Regulating Competition

One of the primary benefits of the private enterprise system is its capacity to deliver goods and services to consumers at least cost. It is only through competition, however, that consumers' needs will be served. The government's competition policy seeks to design incentives to promote competition and discourage collusion and other noncompetitive practices. In defining the rules of the competitive game rather than determining outcomes, it is behavior-oriented rather than results-oriented. In this respect, the U.S. antitrust laws differ from those of other industrialized countries.

In general, the informal "rules" of competition allow profitable firms to expand and prosper, while forcing unprofitable firms to contract and even go out of business. More formal rules have also been developed, such as those prohibiting combinations in restraint of trade, outlawing predatory pricing, and discouraging firms from cooperating rather than competing. There have been exceptions, some formal and others informal. One formal exception is the Webb-Pomerene Act, which allows an exemption from antitrust law for U.S. firms cooperating in international trade. More informal exceptions have been made, on a selective basis, where firms jeopardized by economic losses have been deemed too important to be allowed to fail--for example, the loans and loan guarantees provided by the government to Lockheed and Chrysler. This has created an ad hoc industrial policy by establishing the principle that the government should have sectoral economic goals and should intervene to pursue those goals.

Regulatory commissions have been used to regulate industries in which restrictive competitive practices may become harmful. Examples include the transportation industry (particularly trucking), agriculture, finance, and telecommunications. The Interstate Commerce Commission, for example, was created in 1887 in response to the destructive competition that had

taken place in the railroad industry. The Federal Communications Commission was established to regulate interstate communications, including allocations of radio frequencies and broadcast power. The myriad regulatory bodies overseeing the nation's financial markets--the Federal Reserve Board, the Federal Home Loan Bank Board, and the Securities and Exchange Commission, to mention a few--were created to alleviate market chaos and protect the public against destructive competition. Such competition, though often seemingly beneficial to consumers in the short run, may in the long run be harmful to both producers and consumers if it leads to instability and drives out small producers.

During the Depression the fear that too much competition could be harmful led to the New Deal program of industrial cooperation under the National Recovery Act (NRA). The NRA attempted to stabilize prices and promote production by encouraging self-regulation of industry. It allowed trade associations to draw up codes controlling prices and competition and providing for maximum work hours, minimum wages, and collective bargaining. The NRA was eventually declared unconstitutional by the Supreme Court on the grounds that it invaded intrastate commerce and delegated too much legislative power.

The weight of current thought is that there cannot be too much competition. In recent years, the trend has been to deregulate industries such as air transportation, banking, and communications that have operated under the guidance of regulatory commissions, in the belief that this will promote the benefits usually associated with competitive markets: innovation, lower prices, and responsiveness to the needs of consumers.

Social Regulation

Some government intervention is designed to ensure that markets reflect the public interest. Under some conditions the competitive market, if left to itself, will produce results that are detrimental to general social welfare. This is notably the case where there are negative externalities--that is, where social costs exceed the private benefits.

The classic example of a negative externality is pollution. Typically, a firm that can freely dump waste or by-products into the water, air, or soil without having to pay for the effects will not have an immediate interest in taking account of the social costs involved. The Congress, recognizing this situation, has passed environmental protection laws that require firms to bear at least some of the cost of this externality. Other major areas of social regulation include environmental safety and health, and consumer product safety. These laws create additional non-market costs for firms and may in some cases reduce their ability to compete.

CONCLUSION

Present federal policies toward industry--only a small proportion of which have been discussed above--are an amalgam of disparate policies. An industrial policy, if it is to have any meaning, must be conscious of its goals and coordinated in attempting to achieve them. In a review of industrial policy undertaken a few years ago by the Organization for Economic Cooperation and Development, the U.S. delegation noted that "in line with American economic philosophy, the federal administrative structure is not designed to carry out an active, coordinated policy of promoting industrial growth, and . . . therefore, federal intervention and coordination in this field are of an ad hoc character."^{6/} Nothing that has happened since that statement was made has changed the character of U.S. policies toward industry.

6. The Aims and Instruments of Industrial Policy (OECD, 1975).

CHAPTER IV. ALTERNATIVE INDUSTRIAL POLICY STRATEGIES

Current industrial policies, as described in the foregoing chapter, do not coherently or purposefully address the problems faced by U.S. industry. Other policies aiming at industrial revitalization have been offered for public debate. They cover nearly every traditional field of government policy, from money and banking to education and research.

This chapter summarizes three major strategies that have been proposed, leaving their evaluation to Chapter V. Each represents a general approach rather than a specific policy, and each includes a number of possible options. The options presented here reflect proposals that have been discussed in existing or pending Congressional legislation, or elsewhere in government circles. Not all of them are mutually exclusive.

The three strategies are: to work within the current policy framework; to reform current policy; and to establish new institutions that would address the structural problems of industry.

WORKING WITH CURRENT POLICY INSTRUMENTS

This alternative calls for no new policy reforms to encourage industrial growth, but instead would rely on economic recovery and private market adjustments to solve many existing problems. The underlying assumption is that most of the problems are short-term in nature, a result of the recent recession, and that the rest are amenable to market-oriented solutions. The basic thrust of current economic policy is to stimulate investment and incentives to work and save. ^{1/} These, in turn, are expected to lead to greater productivity, employment, and income.

Current policy relies on monetary and fiscal policy to maintain economic stability with low levels of unemployment and inflation. As a rule, it leaves the fortunes of specific industries to be determined in the marketplace. Some exceptions to the rule may be seen in recent protective measures for motorcycle and speciality steel producers, although the central thrust of policy probably remains untargeted growth.

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1. See the President's message, "America's New Beginning: A Program for Economic Recovery," February 18, 1981.

The Administration's specific program for economic recovery is based on breaking a cycle of negative expectations and revitalizing entrepreneurship. This is to be accomplished by reducing government spending, lowering marginal tax rates, reducing the burden of regulation, controlling the money supply, reducing the role of government in economic decision making, and giving greater latitude to private enterprise. In addition, the Administration has given industrial policy concerns increased emphasis, both within existing political institutions such as the Departments of Commerce and Labor, the Council of Economic Advisers, and the Office of the U.S. Trade Representative, and by creating a special Presidential Commission on Industrial Competitiveness.

REFORMING CURRENT POLICY

A second strategy would add to the standard tools of monetary and fiscal policy a range of measures designed to allow industry to adjust more effectively to changing conditions. These would modernize existing policies that were established under different economic conditions, and that may now have become impediments to growth and efficiency. The goal would be to make American industry more competitive by freeing it from many current restraints in the areas of antitrust policy, government regulation, international trade, and labor market policy.

Antitrust Policy

Antitrust laws have been criticized as placing U.S. firms at a disadvantage when competing with foreign firms that are not similarly constrained. Some also argue that in certain areas, particularly in research and development, joint activities among firms would be more economically efficient than competition (which may duplicate costs). ^{2/}

The Justice Department and the Federal Trade Commission, which are primarily responsible for antitrust enforcement, view the consumer, not the corporation, as the ultimate beneficiary of the antitrust laws. Domestic producers, on the other hand, often see themselves as fighting for their economic existence against highly competitive international firms and feel hobbled by the antitrust laws.

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2. This subject is treated more fully in a forthcoming CBO publication on the federal role in research and development.

U.S. corporations also complain that the U.S. government is alone in its insistence on a high standard of competitive behavior among firms, while other national governments encourage private negotiations and some forms of cooperation among competing firms, particularly in international commerce. Japan's Depressed Industry Law, which allows for recession cartels, and Germany's similar encouragement of industrial "rationalization" are often mentioned. These policies, it is claimed, give foreign firms a competitive advantage against U.S. firms both here and abroad.

One problem is that U.S. firms must compete against state-owned firms, state-subsidized firms, or firms enjoying state authorization to engage in noncompetitive practices (as defined by U.S. antitrust law). U.S. law is limited in reaching all of the restrictive practices that foreign businesses may engage in elsewhere and that affect U.S. markets. Attempts to enforce U.S. laws against firms owned by sovereign governments have met with little success. Increasingly, issues involving competition between large national corporations have been treated as matters for international negotiation rather than for law courts.

A critical issue for antitrust policy is the proper response to cooperative activities by foreign companies that enable them to improve product quality, increase productivity, or lower cost. Proposals have been made to amend U.S. antitrust laws to permit companies to engage in joint ventures for research and development as well as to promote exports in other ways. These proposals raise the question of the extent to which current antitrust laws permit joint research and development.

In 1980, the Antitrust Division of the Department of Justice issued guidelines in this area. It noted that antitrust issues may arise in joint R&D ventures because "joint research may involve or create market-dominating technology, may be conducted by competitors or potential competitors, or may involve restrictive agreements concerning the results of the research." It found that joint research ventures of certain kinds would be acceptable, depending on: (1) their effect on existing and potential competition between the firms involved; (2) the duration, scope, and necessity of any restrictions ancillary to a project; and (3) whether a project led to the creation and abuse of market power by the firms involved.

These guidelines leave a great deal of uncertainty, which is increased by the treble-damage penalties that private plaintiffs may be awarded against firms that violate antitrust laws. Although the Antitrust Division has a business review procedure through which firms can get a decision before committing themselves to a project, it has been criticized because it requires firms to reveal their intentions earlier than they might like and does not guarantee sufficient protection to the proposed enterprise. Moreover, subsequent Administrations are not bound by these decisions.

Efforts are being made to resolve this problem. Several bills have been introduced in the Congress to reduce antitrust risk in joint R&D ventures. In general, they would give the Department of Justice authority to issue Certificates of Review protecting specified plans from both criminal prosecution and private treble-damage suits. In response to administrative changes, two groups of semiconductor and computer companies have already formed research ventures--the Microelectronics and Computer Technology Corporation and the Semiconductor Research Corporation. In addition, the Department of Justice recently granted approval to the Small Business Technology Group, using an obscure section of the Small Business Act as justification.^{3/} The Administration has also proposed revisions of the antitrust laws aimed at strengthening U. S. competitiveness in world trade. These would reduce the amount of money damages that can be won in most civil antitrust suits, and increase patent protection.

Deregulation

Two thrusts have characterized the deregulation movement. One has been toward industries (generally non-manufacturing industries) that are subject to regulation of competition. There have already been major deregulatory efforts in transportation and communications. Further efforts are under way in financial services. The other course taken by deregulation has been to loosen social regulations--consumer protection, environment, job safety, energy, among others--which have been criticized as very costly to business. One often quoted but highly controversial study estimates the cost of compliance with social regulations to have been about \$120 billion in 1980.^{4/} Some see this area of regulation as unfair to small businesses, which are less able to absorb the costs.

Social Regulation. The critics of social regulation of business claim that it has grown to such a degree that the term "regulated industry" no longer has any distinctive meaning--all industry today is in some sense regulated.

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3. "Joint R&D Venture Is Approved," The Washington Post, September 21, 1983.
 4. Murray L. Weidenbaum, Costs of Regulation and Benefits of Reform, Center for the Study of American Business, publication number 35 (November 1980). But see also William K. Tabb, "Government Regulation: Two Sides to the Story," Challenge (November/December 1980), for an alternative point of view.

During the 1960s and 1970s, the Congress passed a variety of social legislation aimed at occupational safety and health, and environmental and consumer protection. New regulatory institutions were established to oversee and administer the programs. Between 1970 and 1980, budget expenditures for social regulation rose in real terms from \$0.5 billion to \$2.6 billion. During the same period employment in federal social regulatory agencies rose from 9,700 to 66,400. One often-cited measure of the growth in regulatory rules issued is the growth in the size of the Federal Register, which expanded from 9,560 pages in 1960 to 74,120 pages in 1980. ^{5/}

This tremendous expansion of social regulations has created a backlash of protest against the social and economic costs of compliance. Many industrial firms complain about the burden of the paperwork and other responses required to comply with regulations. The Congress has responded to some of this criticism, and the current Administration has made many attempts to reduce the burden. Further efforts in this direction are seen by some as necessary to increase productivity and efficiency.

Most regulatory reform proposals are based on the idea that the costs of regulatory programs are excessive compared to the benefits derived from them. Environmental programs in particular have been criticized as setting standards so high that their complete fulfillment requires expenditures far in excess of the marginal benefits. Some reformers would relax the standards to bring costs more in line with actual risks.

Another approach takes the view that the current system overprescribes the technology to be used in abating emissions or making work places safer. This approach would set performance goals that could be met by a variety of means, establishing incentives for meeting them, instead of requiring a specific engineering or technical solution.

The Administration has begun to approach regulatory reform by attempting to rationalize and improve the management of regulation. New procedures for clearing regulations and structuring decision making have been implemented. New regulations are now cleared at both the proposal and the final stages. Regulations already in existence are also identified for review. The cabinet-level Presidential Task Force on Regulatory Relief establishes policy and can also review specific regulatory initiatives. Many of these efforts have been controversial, and views of their effectiveness have varied.

5. Regulation: Process and Politics (Congressional Quarterly, 1982).

Other proposals either now before the Congress or actively debated by reformers include: Congressional control over rule making; court review of rule making to put individuals and firms on an equal footing with regulatory agencies; greater use of cost-benefit analysis and regulatory impact statements; terminating programs, agencies or individual regulations unless Congress renews them (sunset provisions); a regulatory budget to control the costs of federal regulation; regulatory negotiation commissions to open lines of communication and facilitate rule making; and performance goals.

Financial Market Deregulation. Financial markets, which have already gone through major deregulation, are the subject of even further deregulatory efforts by some industrial policy advocates, who believe that antiquated banking laws limit financing and strategic coordination for industrial development. ^{6/} The Glass-Steagall Act, in particular, has been singled out. The act was passed in 1933 to restore public confidence in the financial stability of the commercial banking industry and to maintain the soundness of commercial banks by preventing them from dealing in securities. It limits the right of depository institutions to engage in securities activities and the right of securities firms to receive deposits, thus separating commercial from investment banking.

The act (actually four sections of the Omnibus Banking Act of 1933) was based on the idea that the connection between commercial banking and investment banking encouraged speculative activities and contributed to the bank failures of the Depression. As stated by the Supreme Court, "Congress acted to keep commercial banks out of the investment banking business largely because it believed that the promotional incentives of investment banking and the investment bankers' pecuniary stake in the success of particular investment opportunities was destructive of prudent and disinterested commercial banking and of public confidence in the commercial banking system." ^{7/}

The two issues raised by Glass-Steagall in the context of an industrial policy are whether it unduly restricts investable funds and whether it contributes to myopia on the part of investors. The act, it is argued, artificially limits the potential pool of investment funds by limiting access to banking resources, while at the same time increasing the cost of securities transactions by excluding the commercial banks from a role that

6. See, for example, Lester Thurow's testimony before the House Banking, Finance and Urban Affairs Committee, Subcommittee on Economic Stabilization, June 14, 1983.

7. Investment Company Institute v. Camp, 401 U.S. 634.

they can play in mobilizing financial resources for investment. Repeal of Glass-Steagall, it is claimed, would enhance competition in financial markets, thereby improving services at lower cost and encouraging efficient capital formation by broadening the market. Opponents of repeal argue that removing barriers and encouraging competition would not by itself create additional capital or put more money into investment, but would simply redivide the existing pool of investment funds.

In addition, reforming the Glass-Steagall Act would open the door to the creation of universal banks along the German or Japanese model. The large banking houses of Germany are "full service" banks in the broadest sense of the term. They are able to offer investment loans, buy and own securities, provide export credits, and act as industrial counselors to German firms. In fact, through their equity holdings and the closeness of their relationships with industry these banks are able to have a strong influence on industrial policy. If U.S. banks were allowed to engage in similar activities they would presumably develop a longer time horizon in evaluating the performance of creditor firms, which might be expected to have a positive effect on industrial growth. On the other hand, they might become too closely tied to the performance of a small number of firms. This could impair their judgment of those firms' creditworthiness, with the risk of more severe contractions if key firms became unprofitable.

Trade Policy

In general, industrial policies concerned with trade seek either to stimulate industrial production for international markets or to protect domestic producers from import competition. The rapidly increasing dependence of the U.S. economy on foreign trade, combined with the increasing use of industrial policies by U.S. trading partners, has heightened the sense of need for changes in trade policy.

Stimulation Programs. The United States relies primarily on two export promotion programs, the Export-Import Bank (Eximbank) and the Domestic International Sales Corporation (DISC). ^{8/} Current proposals call for increased funding for Eximbank should demand warrant it, and replacing DISC with a similar tax deferral system. The Export Trading Act, passed into law last year, is also expected to encourage exports by lifting restrictions that prevent small- and medium-sized firms and banks from establishing companies to trade in world markets.

8. For a full discussion of these programs see Chapter III.

Perhaps the most important stimulus to exports would be lower and stabilized exchange rates. The recent high dollar exchange rates, and the volatility that has characterized exchange markets since the end of fixed rates, have led to many proposals for a new international exchange rate system. Such a change would, of course, require international agreement.

The dollar has been estimated to be overvalued by at least 20 percent in relation to its trade-determined value.^{9/} This raises the price of U.S. goods in international markets, while lowering the price of imports by a like amount. The overvaluation of the dollar has been partly linked to exceptionally high U.S. interest rates, which are themselves partly a function of national economic policies. Many believe that the most effective way to lower U.S. exchange rates would be by addressing the interest rate problem through a reduction of chronic budget deficits.

Protection Programs. Proposals to protect domestic industry from import competition fall into two categories: the enforcement and implementation of existing trade laws, and new departures in trade policy such as domestic content legislation.

Many advocates of tougher import restrictions believe that the government already has sufficient authority to assist specific industries threatened by foreign competition, but does not use it vigorously. U.S. trade laws now provide for antidumping penalties and countervailing duties. In addition, the government can apply sanctions when the actions of foreign governments are found to be unfair to U.S. firms (Section 301 of the Trade Act) or when national security concerns are involved (Section 201).

A number of proposals have been made to protect key industries by requiring that imports contain a specified proportion of domestic materials or labor. Such "domestic content" measures would enable less competitive U.S. firms to capture a larger share of the U.S. market.

Labor Adjustment

One school of thought holds that the only industrial policy necessary is to smooth the cost of adjustment as the economy moves toward a new

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9. C. Fred Bergsten, "What Kind of Industrial Policy for the United States," Statement before the Subcommittee on Economic Stabilization, House Banking, Finance and Urban Affairs Committee, June 9, 1983.

industrial structure. This view would have the government assist dislocated workers who cannot readily find alternative employment, thus helping them through the transition. This view has much in common with the industrial policies of Germany and other European countries, which are oriented around labor and community dislocations.

There are three general approaches to aiding dislocated workers: providing services directly to workers to help them find new employment; subsidizing wages to encourage employers to hire more workers; and providing additional income to support workers through an adjustment period. 10/

Readjustment Services. Three types of readjustment services might be provided to aid dislocated workers: job search assistance, retraining, and relocation assistance. Job search assistance, which includes providing labor market information, job search training, and counseling, might help dislocated workers more easily find alternative employment. Worker retraining in particular can help workers acquire new skills. Relocation assistance might enable them to relocate to areas where jobs are more likely to be found.

Wage Subsidies. A second approach to aiding dislocated workers would be to subsidize their wages. This would reduce employers' net costs for hiring unemployed workers, thereby presumably encouraging additional employment of such workers. Wage subsidy programs have been used in Europe to assist labor market adjustment; firms are restricted from using such subsidies to hire new employees rather than maintaining or rehiring employees previously on the company's payroll.

Additional Income Replacement. The third approach to aiding dislocated workers is simply to provide them with additional income support beyond what is now available through unemployment insurance. This helps them during the readjustment period but in itself provides no incentive for readjustment--indeed, it may even cause some workers to postpone necessary readjustment decisions. The Trade Adjustment Assistance program is an example of such a program.

10. The following discussion is based on Congressional Budget Office, "Strategies for Assisting the Unemployed" (December 1982) and Dislocated Workers: Issues and Federal Options (July 1982).

NEW INSTITUTIONS

The third approach to industrial policy calls for the development of new institutions. Proponents of this approach argue that present industrial problems are so new and qualitatively different from previous economic problems that they require new institutions and policies to address them. In addition, it is argued that worldwide industrial competition forces the United States to match the policy devices of other industrial countries with institutions of its own. This is the only one of the three approaches that qualifies as a true break from the past in creating a new, coordinated industrial policy. The other two can be viewed as proposing only marginal change within what amounts to a "no explicit industrial policy" framework.

This approach includes three distinct, but not mutually exclusive, options. They all share the view of industrial policy as an approach to a new class of problems, but differ in their mechanisms and targets. The three major options are:

- o An information/consensus development agency;
- o An executive-branch coordinating agency; and
- o A financial institution.

The following discussion sketches the way these new institutions might function. Much of it deals with generic types rather than particular institutions, since many variations and combinations of each institution have been proposed. To the extent possible they have been presented in their lowest common denominator as pure types, rather than the mixed forms more frequently encountered in actual proposals.

An Information/Consensus Agency

Many believe that a new industrial policy would need only an information and consensus-building agency that would gather, synthesize, and disseminate information on American industry. It could, for example, assess the sectoral impact of government actions such as tax changes, infrastructure development, or R&D spending. It might also examine foreign economic policies and how these affect U.S. industries. It would address itself more to groups and individuals outside of government than to those inside government. Indeed, under most proposals this agency would be independent of the executive branch, perhaps resembling the Federal Reserve System in its structure. It would not, however, have any direct programmatic, regulatory, or policymaking responsibility.

At least four bills introduced in the 98th Congress would create a National Industrial Development Board for the purpose of formulating policy recommendations. H. R. 990 and S. 965, which are identical bills, would create independent boards for this purpose. H. R. 2991 would establish an independent Economic Cooperation Council which, in addition to collecting and analyzing economic data, would advise a separate National Industrial Bank also established by the bill. H. R. 3443 would also create a National Economic Cooperation Council to collect data, promote cooperation, and develop consensus economic policies.

The proposed information/consensus agency would be somewhat like Britain's National Economic Development Council (NEDC or Neddy) or Japan's Economic Planning Agency and Ministry of International Trade and Industry (MITI)--to the extent that MITI develops "visions" of future industrial development and creates information for private initiative. It would lack any of MITI's powers of enforcement, however. It would act largely as a consensus-building agency, with participation by labor, business, and government. It could also provide guidance to coordinate existing policies, somewhat like the coordinating agency discussed below but without its authority.

The need for such an agency is predicated on the idea that it could reduce information costs to firms and increase stability through lessened conflict. Such reasoning stands behind many of the frequently heard calls for tripartite commissions and a national dialogue on economic issues, such as those that led to the development of national consensus on economic policy at the end of World War II. 11/

A key question is whether it would be an outside agency, largely independent of government control but appointed by the President (similar to the Federal Reserve Board), or a semi-independent agency responsible to the Congress and the President (like the independent regulatory commissions), or an executive-branch agency (perhaps attached to the Council of Economic Advisers). This uncertainty underscores the fragility of the central mission of such an agency: to create and foster private initiative through its ability to convince others of the correctness of its analysis and the benefits of following its advice, without the power to enforce compliance. Some variations would link the agency to a source of funds enabling it to back up its analysis with money. However, its credibility and persuasiveness would still be key elements in its effectiveness.

11. See, for example, Herbert Stein, "Agenda for the Study of Macroeconomic Policy" (American Enterprise Institute, 1983).

The effectiveness of such an agency, with or without financial backing, lies in its ability: to provide good long-term analysis of economic trends; to capture both national consensus on economic issues and translate and lead such a consensus into action programs; and to represent fairly the relevant economic interests of competing groups. The issue of where to place and how to structure such an agency so as to maximize its credibility and persuasiveness underscores the importance and political difficulty of consensus development, political representation, and leadership. An additional unresolved issue concerns the relationship between this institution and other organs of economic policy. Would, for instance, its macroeconomic and sectoral forecasts be those used for budget projections by the executive branch and/or the Congress? Would its sectoral projections provide a basis for other government programs? Would the Congress ratify its economic plans by establishing them as official goals? Many of these questions are unanswered in existing proposals.

A Coordinating Agency

A second type of institution may be described as an activist executive agency to coordinate and rationalize federal government programs affecting industry. The goal of such an agency would be to improve executive-branch decision making by reassigning program and budget authority, thereby forcing tradeoffs at different levels. For example, S. 121 would establish a Department of Trade and Industry to strengthen federal policymaking. H. R. 2288, H. R. 2630, and H. R. 3481 would establish similar executive departments. These proposals are predicated on the idea that the federal government affects industrial growth through a variety of actions, which should be coordinated to avoid duplication and conflict.

The coordinating agency is sometimes modeled after France's Ministry for Industrial and Scientific Development, as well as that part of Japan's MITI which actively supports industrial development. It might be an elite bureaucracy capable of making major decisions about the course of the nation's economic development, and--in some variations--carrying out those decisions by subsidizing (usually indirectly) favored activity. This agency could marshal and coordinate resources of the federal government to encourage, where necessary, investment, rationalization of industry through merger or disinvestment, guarantees of minimum prices and government purchases, expenditure of federal funds for research and development, and so on. It might also play a role in worker retraining and relocation programs, unemployment compensation, and other forms of assistance to labor. For example, the agency might be in a position to coordinate economic assistance to workers affected by growing imports resulting from trade competition. Alternatively, it might protect and encourage growing

industries, such as computers, and coordinate labor training programs to ensure that appropriately skilled workers would be matched with emerging job opportunities. The target industries might be determined by policy guidance from the Congress and the executive or from the information agency described above, with specific project criteria to be established based on those guidelines.

The Administration has recently proposed one variation of such an agency in its plan to create a cabinet-level Department of International Trade and Industry (DITI), although its proposal does not go as far toward direct guidance of industry as do some others. DITI would combine functions now found in the Commerce Department's International Trade Administration, other Commerce Department offices, and the Office of the U.S. Trade Representative. It would focus attention and coordinate decision making on trade policy issues, while providing an explicit organization for industrial policy concerns. The proposal does not call for the agency to acquire additional powers or budgetary authority.

Alternatives to the creation of a new cabinet department include: reorganizing existing departments to emphasize trade and competitive concerns; creating a super-cabinet agency similar to the Department of Defense, in which service Secretaries have independent responsibilities under the authority of the Secretary of Defense; or setting up a White House coordinating council similar to the now defunct Council on International Economic Policy (1973-1976), which provided coordination for international economic issues.

A Financial Institution

Several major proposals would establish a financing institution that would in essence be a national industrial development bank, or several regional development banks. At least six bills incorporating versions of the Reconstruction Finance Corporation have been introduced. In addition, S. 331 would create a National Investment Corporation, similar to a development bank, and H. R. 2991 would establish both an Economic Cooperation Council to collect and analyze information and a National Industrial Development Bank to provide long-term financing.

The proposals for a financial institution are often predicated on what are thought to be market failures: (1) the shortage of capital available to distressed firms or regions; (2) shortages of long-term capital; (3) imperfections in the availability of venture capital; and (4) the inability of troubled industries to reorganize themselves. Some supporters eschew a strictly economic rationale and argue that a national development bank is needed to

engineer solutions to problems that cannot be solved by markets alone, such as depressed communities, regions, or industries.

Many analysts have drawn on the Depression-era Reconstruction Finance Corporation (RFC) as a model for such an institution. The RFC was established to refinance failing banks and railroads by lending them additional funds. Later it also invested in the stock of troubled companies.

The RFC was run much as a bank, the primary difference being its ability to apply social criteria in approving projects. It was chartered and capitalized by the Congress and operated independently as an off-budget entity. Many current proposals follow that pattern closely. Proponents argue that a national industrial investment bank should be independent of political control, or at least widely representative of political constituencies (including, at a minimum, representatives of labor, management, and government). It should have adequate capitalization and the ability to raise additional money by borrowing, either through the Treasury or in private capital markets with governmental backing, although the amount of funding varies widely among the proposals. Some would have the bank offer loan guarantees or other incentives, including a variety of direct or indirect subsidies. Others would keep its financial base small, in order to force policy tradeoffs and limit its impact on the economy.

The key feature of such a financial institution would be its ability to target assistance to specific industries, or even firms within industries, to accomplish goals not supported by the market. Depending on its goals and project criteria, it could provide direct assistance to rising, declining, or other types of industries. It might even provide venture capital to new high technology firms, refinance the debt structure of older basic industries, or provide new financing to important industries or key firms (as the government did for Chrysler and Lockheed). Presumably it would set certain conditions on its assistance, relating to industry or firm performance in such areas as investment, wages, employment, and other aspects of business management.

In one version, the financial institution would be a standby facility of last resort. If a key firm or municipality (such as New York City) reached the brink of disaster, the bank could act as financier and broker, buying time for solutions and compromises. This option would translate current ad hoc policy, as established by the Lockheed, Chrysler, and New York City precedents, into a permanent policy.

CHAPTER V. EVALUATING THE OPTIONS

This chapter analyzes the potential benefits and hazards of the major industrial policy options, including those reflected in current legislative proposals. These options, defined in greater length in Chapter IV, are:

- o Keeping to Current Policy. Rather than develop a new industrial policy, this option would use present monetary and fiscal tools to improve the nation's economic performance, relying on the long-term benefits of sustained recovery.
- o Reforming Current Policy. This option would modify public policy to reflect current conditions. The reforms considered here concern antitrust policy, social and financial regulation, international trade, and the labor market.
- o Creating an Industrial Policy Institution. An agency would be established under this option to develop and implement a new industrial policy. Three variations are considered here:
 - An information/consensus agency that would bring government, labor, management, and other groups together to develop consensus on a new industrial policy;
 - A coordinating executive agency with power to oversee the relevant executive departments and agencies and to coordinate or absorb their policymaking powers; and
 - A financial institution that would provide capital, refinancing, or other monetary benefits to industries or firms in order to achieve specific industrial goals.

The following discussion deals with the most apparent advantages and disadvantages of each approach, without attempting to appraise any particular proposal. Most of the proposals introduced in the Congress so far lack the specifics necessary for a thorough evaluation. Moreover, there is little experience to go on, and most of it has been in foreign settings. This chapter seeks only to show how certain key criteria can be applied to the analysis of such options:

- o What is the definition of current policy against which policy changes should be measured?
- o To what extent can the economy's difficulties be resolved by current economic policy, principally monetary and fiscal policy?
- o To what degree would a specific proposal tend to bring politics into economic decision making, and detract from economic efficiency?
- o What is the chance that a particular strategy might fail?

CURRENT POLICY

The key issue the Congress must address in debating a specific industrial policy is whether any new policy is needed. It can be argued that the problems of the U.S. economy today are not qualitatively different from those of the past, and can best be addressed by current institutions and policies.

In some ways, present problems do not appear to be more severe than those of previous times. As shown in Chapter II, the structural changes that occurred in the period from 1920 to 1947 were greater than the current dislocations. Certainly some of the problems are new, at least for the postwar era, and to the participants they are no less painful than earlier transitions. One new development is the greater significance of international competition in today's economy, and another is the high proportion of the population that is employed or seeking employment. The very slowness of economic change may itself be a new problem. On the other hand, the institutions and policies for dealing with economic problems are much more sophisticated than they were, say, at the time of the Great Depression. While economic recovery cannot in itself be expected to solve all of the long-run structural problems facing U.S. industry, including chronic unemployment, it will no doubt diminish the severity of some of them.

Potential Advantages

The advantages of relying on current policy without further intervention rest partly on the contours of the recovery. Table 13 shows how certain broad indicators might be expected to change if the recovery persists through 1986. Rising output should be accompanied by falling inflation. Productivity should also show an upsurge. Moreover, continued recovery